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SUPREME COURT, U. S.

Supreme Court of the United States

October Term, 1965

No. 463

IN THE MATTER

OF

J. E. SCHECTER CORPORATION,

Petitioner,

AND

CARRIER CORPORATION, AMERICAN RADIATOR & STANDARD SANITARY CORPORATION, SARCO COMPANY, INC. and SARCOTHERM CONTROLS, INC.,

Respondents.

PETITIONER'S REPLY BRIEF

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Supplemental Statement

The proceedings before the Referee in Bankruptcy, District Court and United States Court of Appeals, substantiated Petitioner's contention that New York State law was not applicable to the instant matter. Respondents have alluded to New York State law in their brief in opposition and therefore, Point II of this reply brief is directed to the applicability of New York State law, with respect to conflicts of law and the Lien Law.

The balance of this brief is submitted as a refutation of the arguments and rationale propounded by Respondents.

In its zeal to do equity, the lower Court transcended the decisions of *Hiller & Skogland, Inc.* v. *Atlantic Creosoting Co.*, 40 N. J. 6, 190 A. 2d 380 (1963); *Plevy* v. *Schaedel*, 44 N. J. Super. 450, 130 A. 2d 910 (1957); *Wasserman* v. *Klahre*, 24 N. J. Super. 143, 93 A. 2d 638 (1952), and the private improvement statutes cited by Petitioner.

Petitioner replies *seriatim* to each of the contentions found on page 13 of Respondents' brief.

POINT I

The Court of Appeals has applied case and statutory law concerning public improvements to a situation involving private construction and private funds.

Respondents' contention that the clear expression by the Supreme Court of New Jersey, in *Hiller & Skogland, Inc., supra,* that civil liability would be afforded the Respondents, is not supported by the decision and is not authority to impress a trust or lien on funds derived by a subcontractor from the construction of a private improvement. The expression by the Court was *dicta,* but in any event, supports reliance by the Petitioner on *Plevy* v. *Schaedel* and *Wasserman* v. *Klahre, supra,* as shown in this brief.

1. Respondents argue that the scope of N. J. S. 2A:102-10 and 11 and *Plevy* v. *Schaedel, supra,* is distinguishable from the case at bar and that no reliance should be placed thereon, indicating that the *Plevy* case was an action involving officers of the corporate debtor, rather than an action against the statutory trustee for an accounting.

The Court's attention is directed to the following specific provision of N. J. S. 2A:102-11, which extends the scope of the criminal statute to officers, directors or agents of the subcontractor who pay or consent to the appropriation of funds, and thus, makes said agents guilty of a misdemeanor and in so doing, extends the definition of statutory trustee to said agents, officers or directors, as well as the corporate subcontractor as recipient of the funds.

> "Any subcontractor, or any officer, director or agent of the subcontractor, who pays or consents to the appropriation of such funds for any other purpose prior to the payment of all claims and charges * * * is guilty of a misdemeanor."

The facts of the *Plevy* case involve a bankrupt corporation, unpaid subcontractors of a private improvement and N. J. S. 2A:102-10 and thus is analogous to the within matter.

2. *Hiller & Skogland, Inc., supra,* is the established law of New Jersey with respect to public improvements and trust funds derived from public agencies. However, the application of the case must be restricted to issues involving public improvements and public funds. A careful reading of the *Hiller* case and the footnote referred to by Respondents does not overrule or distinguish *Plevy* v. *Schaedel, supra,* or *Wasserman* v. *Klahre, supra,* but in reality, and by direct expression of the Court, reinforces in toto the contention of Petitioner herein that the private improvement criminal statute "on its face, is entirely criminal in impact". The exact wording of the Court's dicta was:

> "As to civil liability arising by virtue of the statute, *see* Samuel D. Wasserman, Inc. v. Klahre, 24 N. J. Super. 143 (App. Div. 1952)." (Emphasis supplied.)

Respondents, through innuendo and rationalization, contend that the aforesaid quote reinforces its argument that a trust should be impressed in the instant matter. However, there exists a difference between the term "civil liability" as used in the *Hiller* case, and the terms "trust" or "lien", as employed in the *Plevy* and *Wasserman* decisions. The precise issue involved in the *Wasserman* case was "did a trust or lien arise by operation of law?", and the precise and sole question in the *Plevy* case " * * * is whether or not N. J. S. 2A:102-10 creates a civil remedy * * * ". The issue was not whether civil liability existed for it is axiomatic that an unpaid subcontractor would be entitled to recover for work, labor and services, goods sold and delivered, or breach of contract, and could have enforced its rights under the provisions of the mechanics' and materialmen's lien law of the State of New Jersey. However, no right of action to impress a trust or lien exists under the private improvement criminal statutes or in equity.

The *Plevy* and *Wasserman* decisions are not at variance with *Hiller & Skogland, Inc.*, nor are they at variance with the Legislative history surrounding the enactment of N. J. S. 2A:44-148 and 2A:102-12.

The *Wasserman* decision referred to R. S. 2:124-16 (forerunners of N. J. S. 2A:102-10). The Court, in noting that the two statutes were similar, indicated the following:

> "Under our former Constitution, as under our present one, the title of a statute operates as a limitation on the enacting clauses, so that a construction which would give the statute a direct effect beyond the object expressed in the title must be rejected. Jordan v. Moore, 82 N. J. L. 552 (E. & A. 1912); St. John, etc., Church v. Gengor, 121

> N. J. Eq. 349 (E. & A. 1937). *It is entirely clear to us that the scope of the statutory provision on which the plaintiffs build their case, is limited to the creation of a criminal offense; and that no civil action can be based directly on the statute.*" (Emphasis supplied.)

The "general equity principles" upon which the lower Court made its determination are at variance with the equity decision of *Guise* v. *John C. Guise, Inc.*, 116 N. J. Eq. 590 (E. & A. 1934). The *Guise* decision, rendered subsequent to the passage of N. J. S. 2A:44-148 and 2A:102-12, relating to work performed and materials furnished, occurred prior to the passage of the statutes. The Court refused to give the unpaid claimant any lien on the funds in the hands of a Court-appointed receiver, since no statute had expressly created the right to such relief. The principle of the *Guise* decision, reiterated in the *Wasserman* case, was as follows:

> "In the absence of statute, one who furnishes material or labor for a building or any structure which is part of the land has no lien, legal or equitable, on the land, the structure, or the contract price."

Thus, New Jersey courts of equity have long since recognized that a statute is required before a trust or lien can be impressed on funds due a subcontractor or materialman.

3. The Hiller & Skogland, Inc. footnote contained the following verbiage:

> "This statute, introduced by a different legislator than chapter 268 and 269, had reference only to

> private construction projects and, on its face, is entirely criminal in impact."

There can be nothing clearer from the foregoing to express the awareness of the Supreme Court of the distinctions between the public and private improvement trust fund statutes of New Jersey. The specific reason for the enactment of N. J. S. 2A:44-148 resulted from a 1928 equity case involving *Grover* v. *Board of Education of the Township of Franklin*, 102 N. J. Eq. 415, aff'd 104 N. J. Eq. 197 (E. & A. 1929).

The Hiller & Skogland, Inc. Court reviewed in detail the *Grover* decision, as well as the statutory enactments existing at the time of the determination of *Grover*. The New Jersey Legislature had enacted vast public construction statutes concerning the Municipal Mechanics' Lien Law (N. J. S. 2A:44-125-142), and the Bond Act (N. J. S. 2A:44-143-147) at the time of the rendition of the *Grover* decision. The public improvement trust fund act, in both its civil and criminal counterparts, had not been enacted. The facts of the *Grover* case, as noted by the Court were strikingly similar to the facts of the *Hiller & Skogland, Inc.* case and are presented herein in summary:

> The Board of Education entered into a contract with Stout to build a school. Pursuant to the Bond Act, Stout furnished the necessary surety and purchased materials from Grover. Grover was paid by Stout out of the contract payments received from The Board of Education, but there was no direction by Stout as to how the payment was to be applied. Stout was indebted to Grover on an antecedent indebtedness and Grover knew that the funds received by him from Stout were derived from The Board of Education construction project. Never-

theless, Grover applied the payment on account of the antecedent debt and thereafter filed a lien for the full price of the school materials. Stout abandoned the contract and his surety on the bond completed it.

The issue presented was whether the surety, as subrogee of the contract, was entitled to the balance of the contract price in the hands of The Board of Education, or whether Grover was entitled to apply the funds received from Stout and enforce its lien action under the Municipal Mechanics' Lien Law. The Court upheld the enforcement of Grover's lien, and in effect, required The Board of Education to pay twice, thus reducing the amount collected by the surety as Stout's subrogee.

Thus the Supreme Court had before it the holding of the *Grover* case which, in effect, stated that moneys paid to the contractor by the public body on the contract "became and was his own money—money which he had legally earned, and which belonged to him alone—just as much as any other money he could have". The *Grover* decision would have undoubtedly required the Court to find for Atlantic Creosoting Co., Inc., which stood in the same legal position as Grover, had it not been for the passage of N. J. S. 2A:44-148.

The Court further indicated that:

"Neither the municipal mechanics' lien law, nor the obligation on the contractor created by the bond act required 'either the contractor or the contractor's creditors to make such primary application of moneys received by the contractor on his contract—nothing either expressed or arising by necessary implication'."

The Court, in the *Hiller* case, further stated with respect to the possibility of overruling the *Grover* decision:

> "But we need not go so far in the instant case as to overrule Grover or quarrel too much with the Restatement, because subsequent legislation has nullified Grover's precedential force and indicated a duty falling within the Restatement exception. We refer to the trust fund act, L. 1932, c. 268, which now reads, N. J. S. 2A:44-148."

From the foregoing, it is apparent that the reason for the enactment of N. J. S. 2A:102-12 and 2A:44-148 was the decision of the *Grover* case, rather than the individual requirements of the different legislators who offered the respective private and public improvement trust fund statutes for enactment.

4. The final contention of Respondents relates to the verbiage employed in the respective public and private improvement trust fund statutes. The belabored construction of the statutes by Respondents is not novel and was presented in the *Plevy* case, *supra* (see p. 18 of the petition).

It would appear that the following propositions can be established with respect to New Jersey law:

A. That the Courts of New Jersey have consistently refused to impress a trust on statutory or equitable grounds where the issue involves funds of subcontractors and contractors engaged in private improvements.

B. That the reasons for the enactment of N. J. S. 2A:44-148 was to close a loophole in the Municipal Mechanics' Lien Law and the Bond Act, and the enactment of

said statute was the result of *Grover* v. *Board of Education of the Township of Franklin.*

C. That the decisions of *Plevy* v. *Schaedel* and *Wasserman* v. *Klahre* are not at variance with the decision of *Hiller & Skogland, Inc.,* or the footnote referred to therein, since the Supreme Court of New Jersey has indicated that the private improvements statutes, N. J. S. 2A:102-9, 10 and 11, "had reference only to private construction projects and, on its face, is entirely criminal in impact".

D. There are no cases in New Jersey involving contractors or subcontractors engaged in private construction which have adopted a construction similar to that rendered by the Court of Appeals, nor have there been decisions in New Jersey indicating that the criminal provisions of N. J. S. 2A:102-10 and 11 are also civil statutes affording the aggrieved party the right to impress a trust under equitable grounds or under the statutes themselves.

E. The fact that a bankruptcy court is also a court of equity does not permit that court or any other federal court to transcend the provisions of Title 28 of the United States Code, Section 1652, the decision of *Erie* v. *Tompkins,* 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, or the numerous decisions predicated thereon.

F. That a denial of the petition for the issuance of a writ of certiorari in the within matter will upset the established legislation and decisional law of the State of New Jersey, which dates to 1898.

POINT II

The laws of the State of New York are not applicable to the instant proceeding.

A. The laws of the State of New York are not appliable herein notwithstanding the fact that the contract between the Petitioner and Crow provided in substance that its terms and construction shall be governed by the said laws. Although as a general rule of law, parties may contract as to the law governing the contract, this rule is not absolute. The more modern view referred to as the doctrine of the "grouping of contracts" or the "center of gravity" is that the Courts instead of regarding as conclusive the parties' intention or the place of making or performance, lay emphasis rather upon the law of the place which has the most significant contacts with the matter in dispute. *Haig* v. *Barnes,* 9 N. Y. 2d 554, 175 N. E. 2d 441; *Auten* v. *Auten,* 308 N. Y. 155, 124 N. E. 2d 99; *Hausman* v. *Buckley,* 299 F. 2d 696; *Wooten* v. *Marshal,* 279 F. 2d 558.

In *Auten* v. *Auten, supra,* Judge Fuld of the New York State Court of Appeals stated:

> "Choosing the law to be applied to a contractual transaction with elements in different jurisdictions is a matter not free from difficulty. The New York decisions evidence a number of different approaches to the question. See, e. g., Jones v. Metropolitan Life Ins. Co., 158 Misc. 466, 286 N. Y. S. 4.
>
> Most of the cases rely upon the generally accepted rules that " 'All matters bearing upon the execution, the interpretation and the validity of contracts * * * are determined by the law of the place where the contract is made' ", while " 'all matters

connected with its performance * * * are regulated by the law of the place where the contract, by its terms, is to be performed.' " Swift & Co. v. Bankers Trust Co., 280 N. Y. 135, 141, 19 N. E. 2d 992, 995; Union Nat. Bank of Chicago v. Chapman, 169 N. Y. 538, 543, 62 N. E. 672, 673, 57 L. R. A. 513; see, also, Zwirn v. Galento, 288 N. Y. 428, 43 N. E. 2d 474; United States Mtg. & Trust Co. v. Ruggles, 258 N. Y. 32, 38, 179 N. E. 250, 251, 79 A. L. R. 802; Restatement, Conflict of Laws, §§332, 358; Goodrich on Conflict of Laws (2d ed., 1938), p. 293. What constitutes a breach of the contract and what circumstances excuse a breach are considered matters of performance, governable, within this rule, by the law of the place of performance. See Richard v. American Union Bank, 241 N. Y. 163, 166-167, 149 N. E. 338, 339, 43 A. L. R. 512; Restatement, Conflict of Laws, §370; Goodrich, op. cit., p. 293.

Many cases appear to treat these rules as conclusive. Other consider controlling the intention of the parties and treat the general rules merely as presumptions or guideposts, to be considered along with all the other circumstances. See Wilson v. Lewiston Mill Co., 150 N. Y. 314, 322-323, 44 N. E. 959, 961-962; Stumpf v. Hallahan, 101 App. Div. 383, 386, 91 N. Y. S. 1062, 1063, affirmed 185 N. Y. 550, 77 N. E. 1196; Grand v. Livingston, 4 App. Div. 589, 38 N. Y. S. 490, affirmed 158 N. Y. 688, 53 N. E. 1125. And still other decisions, including the most recent one in this court, have resorted to a method first employed to rationalize the results achieved by the courts in decided cases, see Barber Co. v. Hughes, 223 Ind. 570, 586, 63 N. E. 2d 417, which has come to be called the 'center of gravity' or the 'grouping of contracts' theory of the conflict of

laws. Under this theory, the Courts, instead of regarding as conclusive the parties' intention or the place of making or performance, lay emphasis rather upon the law of the place 'which has the most significant contacts with the matter in dispute'. Rubin v. Irving Trust Co., 305 N. Y. 288, 305, 113 N. E. 2d 424, 431; see, also, Jones v. Metropolitan Life Ins. Co., supra, 158 Misc. 466, 469-470, 286 N. Y. S. 4, 8-9; Jansson v. Swedish American Line, 1 Cir., 185 F. 2d 212, 30 A. L. R. 2d 1385; Barber Co. v. Hughes, supra, 223 Ind. 570, 63 N. E. 2d 417; Boissevain v. Weil, (1949) 1 K. B. 482, 490-492; Cook, 'Contracts' and the Conflict of Laws; 'Intention' of the Parties, 32 Ill. L. Rev. 899, 918-919; Harper, Policy Bases of the Conflict of Laws: Reflections on Rereading Professor Lorenzen's Essays, 56 Yale L. J. 1155, 1163-1168; Note, Choice of Law Problems in Direct Actions Against Indemnification Insurers, 3 Utah L. Rev. 490, 498-499.

Although this 'grouping of contacts' theory may, perhaps, afford less certainty and predictability than the rigid general rules (see Note, op. cit., 3 Utah L. Rev. 490, 498), the merit of its approach is that it gives to the place 'having the most interest in the problem' paramount control over the legal issues arising out of a particular factual context, thus allowing the forum to apply the policy of the jurisdiction 'most intimately concerned with the outcome of (the) particular litigation'. 3 Utah L. Rev., pp. 498-499. Moreover, by stressing the significant contacts, it enables the Court, not only to reflect the relative interests of the several jurisdictions involved (see Vanston Bondholders Protective Committee v. Green, 329 U. S. 156, 161, 162, 67 S. Ct. 237, 239, 91 L. Ed. 162), but also to give effect to

> the probable intention of the parties and consideration to 'whether one rule or the other produces the best practical result'. Swift & Co. v. Bankers Trust Co., supra, 280 N. Y. 135, 141, 19 N. E. 2d 992, 995; see Vanston Bondholders Protective Committee v. Green, supra, 329 U. S. 156, 161, 162, 67 S. Ct. 237, 239."

In the instant proceeding it is not the contract which is in question but rather certain rights created by statute. The subject contract was between the general contractor Crow and the Debtor in connection with the improvement of real property in New Jersey. The Respondents were not parties to said contract and have no rights thereunder.

B. Section 70 and 71 of the Lien Law of the State of New York are concerned by their very terms only with funds arising from improvements or contracts relating to real property in the State of New York.

The present Sections 70 *et seq.* of the New York Lien Law are the successors to Sections 36 *et seq.* of said law and are commonly referred to as the trust fund sections.

In *Allied Thermal Corporation* v. *James Talcott Inc.*, 3 N. Y. 2d 302, the plaintiff alleged that (a) New York is the residence of the principals to all relevant contracts and of the diverting parties; (b) the execution of the contracts between the general contractor and the sub-contractor took place in New York; (c) the payment of the trust funds to the sub-contractor occurred in New York; (d) the diversion of the trust fund took place in New York; and (e) the real property which was the subject of the improvement was located in Pennsylvania, The Court of Appeals, in holding that a supplier of material could not use the provisions of the New York Lien Law to force an

accounting for funds received for supplying materials to an improvement of premises located in Pennsylvania, stated as follows:

> "Desmond, Judge. The question is as to whether the language 'for the improvement of real property' in section 36-b of the Lien Law, Consol, Laws, c. 33 (funds received by subcontractor constitute trust funds, etc.) applies to the improvement of real property in States other than New York. Of course, if we read that statute literally and off by itself, there is nothing in it limiting it to subject real property in this State. However, section 36-b must be read as part of articles 2, 3 and 3-A of the Lien Law which constitute New York State's complete scheme for the protection of the rights of those who provide labor and materials for the improvement of real property. At no place in any of the numerous sections which together make up that statutory scheme is there definite reference to 'New York State'. It was, apparently considered so obvious that New York real property alone was involved that it was unnecessary to say so. The phrase: 'for the improvement of real property' which we are here construing in section 36-b recurs over and over throughout these sections. In no place is 'New York State' mentioned but in no place is there any doubt that New York State alone is intended. In fact, when 'real property' is mentioned in any of our statutes there is never a specification that New York real property alone is intended, as witness the definitions in section 2 of the Real Property Law, Consol. Laws, c. 50, subdivision 6 of Section 2 of the Tax Law, Consol. Laws, c. 60, section 40 of the General Construction Law, Consol. Laws, c. 22, as well as in section 2 of the Lien Law itself.

> The purpose of section 36-b of the Lien Law is precisely the same as that of all the other sections in articles 2, 3 and 3-A of that law, that is, to provide special protection for those whose services and materials enhance the value of real property. Since that is the general purpose of all these enactments there seems no reason to single out section 36-b as having to do with the improvement of real property in some other State.
>
> Other States including Pennsylvania (see Martindale-Hubbell, Lawyers' Directory, Vol. III, Digest of Pennsylvania Laws, under heading 'Mechanics Liens') have their own peculiar systems of statutory protections for materialmen and laborers. Only confusion could result from applying one part of a particular State's statutory system to a real property improvement situated in another State where the local statutory scheme is quite different."

In *Allied Thermal Corporation* v. *James Talcott, Inc. supra,* notwithstanding that the applicable provisions of the New York Lien Law in force at that time made no definite reference to New York State, the Court nevertheless held that "it was apparently considered so obvious that New York real property alone was involved, that it was unnecessary to say so". Section 70 of the New York Lien Law went further by specifically limiting itself to improvements of real property in this state.

A lien and any trust fund alleged to flow therefrom, does not exist at common law, is no part of the contract to be enforced, is purely the creature of statute and has no extra territorial effect.

In *Birmingham Iron Foundry* v. *Glen Cove Starch Manufacturing Company*, 78 N. Y. 30, 32, the Court held:

> "Section one of the statute provides that 'any person who shall hereafter perform any labor or furnish any materials in building, altering or repairing any house, building or other improvement upon lands or appurtenances to such house or other building, by virtue of any contract with the owner thereof or his agent, or with any contractor or subcontractor.' etc., shall have a lien. Such a lien does not exist at common law. It is no part of the contract to be enforced where that can be enforced. It is purely the creature of the statute. The statute has no extra territorial force. It was intended for the protection of those who performed labor or furnished materials within this State. When this engine was brought into this State and put into this factory, it belonged to the defendant. The plaintiff did not furnish any material in this State. It cannot, therefore, have the benefit of this statute."

That statutes are to be strictly construed is a well settled rule of law which is more compelling in the case of a statute penal in nature. For example, the former Sections 36-a and 36-b of the Lien Law creating trust funds referred merely to "real property". The courts were not willing to expand the statute to include public improvements. *American Laundry Machinery Co.* v. *Union Trust Co.*, 153 Misc. 55, *Vulcan Rail and Construction Co.* v. *Westchester County*, 250 App. Div. 212. As a result of this construction by the courts, the Lien Law was amended to include "public improvements". Further in order to codify *Allied Thermal Corporation* v. *James Talcott, Inc.*,

the words "in this state" were added to Section 70 of the Lien Law which in its present form states:

> "The funds described in this section received by an owner for or in connection with an improvement of real property in this state, or received by a contractor under or in connection with a contract for an improvement of real property or a contract for a public improvement in this state, or received by a subcontractor under or in connection with a subcontract made with the contractor for such improvement of real property or public improvement or made with any subcontractor under any such contract, and any right of action for any such funds due or earned or to become due or earned, shall constitute assets of a trust for the purposes provided in section seventy-one of this chapter."

Clearly, the trust funds created by the Lien Laws of the State of New York related only to property in this state, regardless of the parties' choice of law relative to the contract, and the New York Lien Law cannot be extended to cover property in the State of New Jersey.

CONCLUSION

It is respectfully submitted that the petition and reply of the Petitioner conclusively demonstrates that the Respondents have no right to impress a trust under the applicable statutes or by reason of equitable principles.

Respectfully submitted,

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